

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

- against -

03 Civ 7045 (HB)

BRIGHTPOINT, INC.,  
AMERICAN INTERNATIONAL GROUP, INC.,  
PHILLIP BOUNSALL,  
JOHN DELANEY, AND  
TIMOTHY HARCHARIK,

Defendants.

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Electronically Filed  
GOVERNMENT'S MEMORANDUM OF LAW  
IN SUPPORT OF APPLICATION TO  
INTERVENE AND TO STAY DISCOVERY

TIMOTHY M. MORRISON  
Acting United States Attorney  
Southern District of Indiana  
10 West Market Street  
Suite 2100  
Indianapolis, Indiana 46204  
(317) 226-6333

Winfield D. Ong  
Assistant U.S. Attorney  
(Of Counsel)

**PRELIMINARY STATEMENT**

The government respectfully submits this memorandum of law in support of its motion to intervene in this case ("the Civil Case") and to stay discovery because of the pendency of a parallel criminal grand jury investigation (the "criminal matter") in which the defendant in this civil case, Timothy Harcharik, is a target. The same underlying facts are at issue in both the civil and the criminal matters. A stay of discovery is necessary in the Civil Case to preserve the secrecy of the ongoing grand jury proceedings. Additionally, it is necessary to prevent the broad civil discovery from circumventing the more limited discovery that will be available to defendants who have been indicted in the Criminal Case. Moreover, a stay of the discovery herein could promote judicial economy. Accordingly, the United States respectfully requests that the Court: (1) permit the government to intervene pursuant to Fed. R. Civ. P. 24 and (2) order, pursuant to the Court's inherent power, that discovery in the instant case shall be stayed until the conclusion of the criminal matter. The U.S. Securities and Exchange Commission ("SEC") does not oppose this motion.

**FACTUAL BACKGROUND**The Fraudulent Scheme

The civil and criminal cases both arise out of an agreement that Harcharik and others at Brightpoint, a public company headquartered in Indianapolis, Indiana, negotiated with American International Group, Inc. (AIG) in December 1998 and January 1999. The troubling circumstances surrounding the agreement have been set forth in an SEC complaint and order, *In the Matter of American International Group, Inc.*, Exchange Act Release No. 48477 (September 11, 2003) (the "Release Order"). In short, in October 1998 Brightpoint issued a press release predicting it would incur as much as \$18 million in losses for the year. By December 1998, however, it recognized that it was going to lose approximately \$11.9 million more. In order to bring its actual losses in line with its public announcement, Harcharik and others at Brightpoint negotiated an agreement with AIG that purported to be an insurance policy but in fact was essentially nothing more than a no-interest loan from AIG to Brightpoint because no risk was transferred from Brightpoint to AIG. Disguising the agreement as an insurance policy, however, allowed Brightpoint to claim \$11.9 million in insurance proceeds for the year, while amortizing its consideration for the agreement as insurance premiums over the three year life of the agreement, thereby bringing its losses in line with its public announcement.

The falsely inflated income for 1998 was stated in Brightpoint publicly reported the material misrepresentation about its 1998 operating results in Brightpoint's 1998 Form 10-K, which was filed with the SEC on March 31, 1999. Brightpoint republished the misleading 1998 financial results in its Forms 10-K filed for 1999 and 2000. Further, Brightpoint filed a registration statement on Form S-8 on September 27, 1999, which incorporated by reference Brightpoint's 1998 Form 10-K. Delaney signed each of these filings as vice president and chief accounting officer of Brightpoint. In addition, aspects of the fraudulent accounting were included in Brightpoint's 10-Qs in 2000, and until the fraudulent nature of the agreement was uncovered by the SEC and Brightpoint's public auditors.

As a result of the agreement, Brightpoint restated its earnings for 1998 twice. The first restatement assumed that the agreement was insurance, but accounted for all of Brightpoint's payments due under the agreement in 1998, thereby negating any benefit from the agreement. The second restatement did not change the accounting significantly, but Brightpoint acknowledged that the agreement was not insurance.

#### The Civil And Criminal Matters

On September 11, 2003, the SEC filed its complaint in the civil case, however, it is counsel's understanding that no discovery has been done. Both the civil complaint and criminal investigations focus on violations of the federal securities laws by participation in the fraudulent scheme described above. A

federal grand jury in the Southern District of Indiana is conducting an ongoing investigation of the illegal conduct that is the subject of the civil and criminal Cases.

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### **ARGUMENT**

#### **POINT ONE**

##### **Intervention is Appropriate**

Rule 24(a) of the Federal Rules of Civil Procedure provides that a party may intervene as of right in an action when he "claims an interest related to the property or transaction which is the subject of the action and the applicant is so situated that the disposition of the action may as a practical matter impair or impede the applicant's ability to protect that interest . . . ." Fed. R. Civ. Proc. 24(a)(2). Rule 24(b) alternatively permits permissive intervention "when [the] applicant's claim or defense and the main action have a question of law or fact in common." Fed. R. Civ. Proc. 24(b)(2). As described below, intervention is warranted here under both Rule 24(a) and Rule 24(b).

When government prosecutors have advised courts that they are conducting criminal prosecutions or investigations of individuals involved in a pending civil action, the courts have regularly permitted the government to intervene in order to request a stay of discovery in the civil case. See, e.g., SEC v. Chestman, 861 F.2d 49, 50 (2d Cir. 1988); SEC v. Doody, 186 F. Supp.2d 379, 381 (S.D.N.Y. 2002); Bridgeport Harbour Place I, LLC, 269 F. Supp.2d 6, 8 (D. Conn. 2002); SEC v. Downe, No. 92

Civ. 4092(PKL), 1993 WL 22126 at \*11 (S.D.N.Y. Jan. 26, 1993); Twenty First Century Corp. v. LaBianca, 801 F. Supp. 1007, 1009 (E.D.N.Y. 1992). Allowing the government to intervene in this case under Rule 24 is clearly appropriate.

Intervention is warranted as a matter of right under Rule 24(a)(2) in light of the strong interest of the government and the public in the enforcement of criminal laws. See, e.g., Cascade Natural Gas v. El Paso Natural Gas Co., 386 U.S. 129, 132-36 (1967) (permitting intervention as of right by State in antitrust proceedings because of public interest in effective competition); SEC v. Realty & Improvement Co., 310 U.S. 434, 458-60 (1940) (SEC should have been permitted to intervene in bankruptcy proceeding because resolution of that proceeding might "defeat the public interests which [the SEC] was designated to represent"). That interest may be substantially impaired if discovery were allowed to continue in this matter before the resolution of the criminal case, as we explain further in Point II below. Indeed, courts have specifically recognized that the government "has a discernible interest in intervening in order to prevent discovery in the civil case from being used to circumvent the more limited scope of discovery in the criminal matter." Chestman, 861 F.2d at 50; see Morris v. Amer. Fed. of State, County and Municipal Employees, No. 99 Civ. 5125(SWK), 2001 WL 123886 at \*1 (S.D.N.Y. Feb. 9, 2001) (permitting District Attorney to intervene in civil action to request stay of discovery); Board of Governors of the Federal Reserve System v.

Pharaon, 140 F.R.D. 634, 638 (S.D.N.Y. 1991) (same); First Merchants Enterprise, Inc. v. Shannon, No. 88 Civ. 8254(CSH), 1989 WL 25214 at \*2-\*3 (S.D.N.Y. Mar. 16, 1989) (allowing United States Attorney to intervene in a civil action).

Intervention is also warranted as an exercise of this Court's discretionary authority because there is substantial overlap in the core factual allegations underlying this action and the factual questions may well be resolved in the criminal matter -- namely, whether Mr. Harcharik violated the securities laws and defrauded the investing public and others.

The motion is also timely. Mr. Harcharik has been notified that the grand jury's investigation is substantially complete and that the United States Attorney's Office expects to present an indictment, if at all, to the grand jury within approximately ten weeks, so that this motion to intervene has been filed before any civil discovery has taken place.

Finally, the government's intervention for the limited purpose of seeking a stay will not prejudice any party's rights. The government seeks only a stay, and its intervention will not alter the parties' respective positions. In fact, the criminal prosecution may benefit the civil parties, by bringing out facts relevant to the civil case and streamlining the ensuing litigation. Accordingly, this Court should permit the government to intervene.

**POINT TWO**

**Stay of Discovery Should be Granted**

District courts have the inherent authority to stay their own civil proceedings. See Landis v. North American Co., 299 U.S. 248 (1936).

In making the determination whether to exercise its discretion to stay the discovery, the Court should balance the following considerations:

- (1) the private interest of the plaintiffs in proceeding expeditiously with the civil litigation as balanced against the prejudice to the plaintiffs if delayed; (2) the private interests of and burden on the defendant; (3) the convenience to the courts; and (4) the interest of persons not parties to the civil litigation [the prosecution]; and (5) the public interest.

Twenty First Century Corp., 801 F. Supp. at 1010 (citations and quotations omitted).

As described below, all of these factors weigh in favor of granting a stay of discovery in the Civil Case until the conclusion of the criminal prosecution.

**Discussion**

In this case, the possibility of prejudice to the prosecution of the target and the Grand Jury's continuing investigation, the public interest in effective enforcement of the criminal laws and the interests of judicial economy weigh heavily in favor of a stay. The parties to this civil action will not be substantially prejudiced by the stay the Government seeks. Indeed, it is likely that the parties will benefit from the prior resolution of the criminal case, through the

development and preservation of evidence and the narrowing of factual and legal issues.

1. Prejudice to the Government. The Grand Jury is actively pursuing this investigation through its subpoena power and the investigative efforts of this Office, the FBI and the USPIS. As in any criminal investigation, the identification of potential Government witnesses involves continuing assessments of the potential criminal liability of certain witnesses. Such assessments, which are critical to the development of the Government's case, require the ability to obtain truthful and complete information from persons who are reluctant to speak because they may themselves face serious penal sanctions. This process is facilitated by the cloak of Grand Jury secrecy, and often involves the use of cooperation agreements or nonprosecution agreements.

Requiring potential Government witnesses to comply with deposition notices, interrogatories or other discovery demands in the civil action would seriously impede the Government's prosecution of the criminal defendants and other potential defendants. First, such testimony would subject potential witnesses to the risk of intimidation or subornation of perjury. Thus, the target, having learned the identity of Government witnesses, could attempt to use threats of economic or physical retaliation to prevent those witnesses from testifying, or to cause them to alter their testimony. Even a perceived threat of such intimidation would have a powerful chilling effect on the

Grand Jury's investigation. See Downe, 1993 WL 22126, \*13 ("where a party or witness in a civil case is cooperating with a grand jury investigation relating to the subject matter of the civil suit, there is a compelling reason to stay discovery of the civil case pending resolution of the criminal investigation").

Second, disclosure of the substance of potential testimony in the criminal trial would facilitate efforts by the criminal defendant and other targets to manufacture evidence and tailor their defenses to the Government's proof. For example, there is a risk that the criminal defendant and/or other targets, armed with deposition testimony, witness statements from the SEC's investigative files and other discovery could coordinate their defenses in an attempt to explain away the Government's proof. Similarly, there is a risk that the criminal defendant could attempt to destroy documentary or other physical evidence that corroborates such statements. As Chief Judge Mukasey observed recently:

The stakes in a criminal case are high, and temptations of perjury, subornation and intimidation are ever present. Accordingly, the government is not required to turn over information that will permit a defendant to preview the government's case and tempt him to tailor proof to explain it away, or see to it that the government's proof is not presented.

United States v. Sindone, 2002 WL 48604, \*1 (S.D.N.Y. Jan. 14, 2002) (citations omitted); See also United States v. Percevault, 490 F.2d 126, 131 (1974) ("[f]ear of intimidation of witnesses

and concern over efforts to suborn perjury were not flights of fantasy by those who drafted Rule 16").

Third, discovery of witnesses who have testified before the Grand Jury would circumvent the secrecy of those proceedings by allowing parties to the civil litigation to compel the disclosure of the substance of that testimony.<sup>1</sup>

2. Public Interest. The overriding public interest in enforcement of the criminal laws weighs heavily in favor of a stay. The investigation involves a significant fraudulent scheme. In addition to the charges of securities fraud, wire fraud and bank fraud, the Grand Jury is investigating allegations of obstruction of justice. Allowing the criminal case to proceed will vindicate not only the public's interest in compliance with the federal securities laws implicated by this civil action, but also other interests implicated by additional criminal charges. Volmar, 152 F.R.D. at 40 ("The public certainly has an interest in the preservation of the integrity of competitive markets. However, the criminal investigation serves to advance those same interests."); Plumbers Fund, 886 F. Supp. at 1140 ("Because of the overlapping issues in the criminal and civil cases, the criminal prosecution will serve to advance the public interests at stake here."). A stay of civil discovery will not involve any continuing harm to the public. Cf. SEC v. Dresser Indus., 628 F.2d 1368, 1377 (D.C. Cir.), cert. denied, 449 U.S. 993 (1980)

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<sup>1</sup>Under Rule 6(e), Fed. R. Crim. P., a Grand Jury witness is not forbidden from disclosing the substance of his testimony.

(denying stay on ground that is might permit "[d]issemination of false or misleading information by companies to members of the investing public").

3. Interests of Unrepresented Parties The fraudulent scheme involved in these proceedings resulted in harm to a large number of victims who are not parties to this civil action. Any criminal convictions in this case likely will result in orders of restitution and/or forfeiture, for the benefit the victims of the scheme. Thus, the interests of all parties as a whole would be better represented by a stay that avoids prejudice to the criminal case.

4. Judicial Interests. Allowing the criminal investigation to proceed ahead of the civil action likely will result in a narrowing of the factual and legal issues before this Court. Volmar, 152 F.R.D. at 40; Brock v. Tolkow, 109 F.R.D. at 120. In addition, convictions may increase the likelihood of settlements by other parties to this action. Plumbers Fund, 886 F. Supp at 1140. The criminal process may create an evidentiary record that will limit the scope of subsequent discovery in the civil case, thus conserving the resources of both the parties and the Court in completing the civil discovery process and resolving any disputes that may arise out of that process. Volmar, 152 F.R.D. at 41 ("availability of transcripts and other evidence from the criminal trial may eliminate altogether the need for certain depositions"). Accordingly, the interests of judicial economy are better served by the stay the Government seeks.

5. Lack of Prejudice to Civil Parties. As courts have repeatedly held, any prejudice resulting from a stay of parallel civil proceedings is minimized by the fact that the parties "will have appropriate opportunity for discovery at the conclusion of the criminal trial." SEC v. Princeton Econ. Int'l Ltd., 2000 WL 193131, \*2 (citing SEC v. Chestman, 861 F.2d at 50). And if the defendant is indicted by the Grand Jury he will be provided with discovery pursuant to the Federal Rules of Criminal Procedure. To the extent such defendants wish to make that discovery available to their family members or other defendants in this action, they are not barred from doing so. Moreover, the Grand Jury investigation and criminal proceedings will develop an evidentiary record and preserve that record for use in the civil action. Plumbers Fund, 886 F. Supp. at 1140 ("evidence gathered during the criminal prosecution can later be used in the civil action"). Accordingly, the stay requested by the Government would not prejudice the civil litigant in this action.

#### CONCLUSION

For the foregoing reasons, the government's motion to intervene and for a stay of discovery in this civil action should be granted.

Dated: April 12, 2005

Respectfully submitted,  
TIMOTHY M. MORRISON  
Acting United States Attorney

By: s/  
Winfield D. Ong (WO 1730)  
Assistant U.S. Attorney  
(Of Counsel)